IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1361

CALVERT FIRE INSURANCE COMPANY,
A PENNSYLVANIA CORPORATION,
Petitioner,

vs.

AMERICAN MUTUAL INSURANCE COMPANY,
AN ILLINOIS CORPORATION,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE ILLINOIS APPELLATE COURT.

THOMAS J. WEITHERS,
D. KENDALL GRIFFITH,
HINSHAW, CULBERTSON, MOELMANN,
HOBAN & FULLER,
69 West Washington Street,
Chicago, Illinois 60602,
Counsel for Respondent, American Mutual Reinsurance Company.

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INDEX.

TABLE OF AUTHORITIES.

Cases.

Other Authorities.

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QUESTIONS PRESENTED.

I. Does the judgment of the Illinois Appellate Court on an interlocutory appeal from an interlocutory order deciding only one issue in the case, on the pleadings, which issue may become moot, present a judgment appropriate for the issuance of the writ of certiorari to the Illinois Appellate Court?

II. Does the judgment of the Illinois Appellate Court, which presents no important question of federal law and creates no conflict of decision and which, if reversed, would be subject to reinstatement after presentation of evidence and consideration of a defense under federal law not yet at

issue, present a judgment appropriate for the issuance of a writ of certiorari to the Illinois Appellate Court?

STATEMENT OF THE CASE.

Petitioner states that its statement of the case is taken from the opinion of the Illinois Appellate Court but chooses to characterize the facts in a manner not done by the Illinois Appellate Court. Respondent respectfully directs the Court's attention to the Statement of Facts set forth in the opinion of the Appellate Court.[1]

The litigation was commenced in July of 1974 when American Mutual Reinsurance Company ("American Mutual") filed a simple contract action against Calvert Fire Insurance Company ("Calvert") in the Circuit Court of Cook County, Illinois. American Mutual in its complaint alleged that Calvert breached its reinsurance contract with American Mutual whereby Calvert agreed to provide reinsurance for American Mutual. Calvert was the only one of the one hundred reinsurers having similar, separate, contracts with American Mutual which attempted to avoid its liability under its reinsurance contract.

Not until some six months after the filing of the action did Calvert file an answer and counterclaim alleging as defenses and in support of its counterclaim that American Mutual had made misrepresentations with reference to the contract, and alleging violation of the federal, Illinois and Maryland securities laws.

The Circuit Court of Cook County sustained American Mutual's motion to dismiss only those portions of Calvert's answer and counterclaim based upon the federal and Illinois and Maryland securities laws. On interlocutory appeal from that order, the Illinois Appellate Court affirmed the order of the trial court. The remaining issues in the case are pending for trial in the Circuit Court of Cook County.

1. Appendix G to Petition.

REASONS FOR DENYING THE WRIT OF CERTIORARI.

Summary of Argument.

The petition should be denied because the judgment of the Illinois Appellate Court is not final for purposes of certiorari and may be rendered moot by further proceedings. Even if reversed, the judgment could be reinstated after presentation of legal defenses not yet of issue and evidence.

The issues presented on this petition are not related in any way to the issues presented to this Court in the case of *Will* v. *Calvert Fire Insurance Co.* (U. S. No. 693, 1977 Term). That case presents the questions of whether the District Courts of the United States have been deprived of all discretion to stay proceedings before them in any case involving a claim of a right arising under a federal law and whether a mandamus should issue from a Court of Appeals to a United States District Court to require an immediate adjudication of any federal claim when the identical legal issues are pending in the state courts between the same parties.

There is no important question of federal law presented by the petition nor is there any conflict of decision arising from the decision of the Illinois Appellate Court. The so-called "security" issue (the quotation marks are Calvert's) raised by petitioner is unique. It has never before been presented to a court and may well never be presented again because of the unusual nature of the facts in this case.

Finally, the decision of the Illinois Appellate Court is correct and follows the laws interpreted by this Court. Two different courts have held, and a third announced that it would hold, that the insurance transaction in question did not constitute the sale of a security.

I.

The Decision of the Illinois Appellate Court Is Not Final for Purposes of Certiorari and the Issue Decided May Become Moot.

The petitioner prays that a writ of certiorari should issue to review a judgment of the Illinois Appellate Court which affirmed an interlocutory order of the Circuit Court of Cook County striking and dismissing portions of petitioner's answer and counterclaim insofar as they alleged defenses and counterclaims based upon the federal and state securities laws.

The judgment of the Illinois Appellate Court is not a final judgment under Title 28 U. S. C. §1257 as interpreted by this Court.[2] Nor does the judgment of the Illinois Appellate Court come within any of the exceptions to the rule of finality as enunciated by this Court,[3] and petitioner does not claim that it does.

The petitioner appears to concede that the judgment is not final (petition, p. 9) and states that it would be "unusual" for this Court to grant the writ of certiorari to review an interlocutory judgment of this type.

The case giving rise to the issue presented by Calvert's petition for certiorari is still pending in the Circuit Court of Cook County and no trial has been had and no final judgment has been entered. The remaining issues in the case, including Calvert's defense and counterclaim based upon allegations of fraud, are yet to be adjudicated.

If Calvert should sustain its defense or counterclaim based upon fraud, the order striking its "security" claims would become moot.

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2. *Republic Natural Gas Co.* v. *Oklahoma*, 334 U. S. 62 (1948); *Radio Station WOW, Inc.* v. *Johnson*, 326 U. S. 120 (1945); *Gospel Army, Inc.* v. *Los Angeles*, 331 U. S. 543 (1947).

3. *Cox Broadcasting Corp.* v. *Cohn*, 420 U. S. 469 (1975).

If Calvert should not prevail on trial, it would have the right to seek review after final judgment in the Illinois courts, and ultimately, to petition this Court for a writ of certiorari to review the very issue presented by the present petition, if it would then be a viable issue.

In an attempt to bestow an aura of finality upon the order striking portions of its pleadings which was affirmed by the Illinois Appellate Court, Calvert contends that if this Court should determine that the sale of reinsurance by Calvert for a premium constituted a purchase of a "security" by Calvert, that Calvert would be entitled to "automatic rescission" of its contract under the Securities Act of 1933.

Petitioner ignores the fact that if this Court should so hold, at most, a fact question under the securities law would be presented to the Circuit Court of Cook County, determinable only after the presentation of evidence.

Petitioner also ignores the fact that if this Court should determine that the transaction constituted the purchase of a "security" that on remand to the Circuit Court of Cook County, American Mutual would then be required to plead to the "security" issue and would plead as a defense that the transaction was exempted from registration available under § 4(2) of the 1933 Act. (15 U. S. C. § 77d(2)) Because no court has yet held that the transaction constitutes the sale of a "security" the assertion of that defense would have been premature in prior proceedings.

There are, therefore, an issue of federal law and issues of fact, potentially determinative of the merits of the "security" issue, which have not yet been adjudicated.

II.

The Issues Presented by the Petition for Writ of Certiorari Are Entirely Separate from the Issues Before This Court in the Case of Will v. Calvert Fire Insurance Co.

The case of *Will* v. *Calvert Fire Insurance Co.* (U. S. No. 693, 1977 Term), in which this Court granted a writ of certiorari to the Court of Appeals for the Seventh Circuit, concerns questions totally unrelated to the issues presented by Calvert's petition for a writ of certiorari. The issues presented in the *Will* case are (1) whether the District Courts have been deprived by this Court's decision in *Colorado River Water Conservation District* v. *United States*, 424 U. S. 800 (1976), of all discretion to stay proceedings pending before them in the interest of judicial economy and to avoid duplicative litigation, (2) whether the United States District Courts have a clear legal duty enforceable by mandamus "immediately" to try cases before them despite the fact that prior commenced litigation between the same parties raising the same legal and factual issues, is proceeding in a state court in a manner that may well render the entire federal case moot, and (3) whether this Court's opinion in *Colorado River* entitles a litigant effectively to compel a United States District Judge by writ of mandamus to engage in a race with the state court to decide identical legal issues pending in both courts between the same parties when the judge reasonably believes such race to be unnecessary and wasteful.

The issues raised in the *Will* case relate solely to the discretion of a United States District Judge to defer ruling on a federal question when that same question is being litigated in another court. There is no substantive question of federal securities law presented to this Court in the *Will* case, but only questions of procedure.

Calvert's petition does not in any way intimate there is a relationship between the issues presented by its position and the issues in the *Will* case.

The granting of the petition for writ of certiorari in this case would in no way eliminate or simplify the issues presented in the *Will* case.

III.

There Is No Important Question of Federal Law Presented by the Petition or Any Conflict of Decision Arising from the Decision of the Illinois Appellate Court.

Petitioner does not appear to even attempt to advise this Court that the "securities" issue presented by its petition presents an important question of federal law nor does Calvert point out any conflict of decision arising from the decision of the Illinois Appellate Court.

The fact situation upon which Calvert predicates its claim of the existence of a "securities" issue, is both narrow and unique. A reinsurance pool is an arrangement whereby various reinsurers, such as Calvert, particpate in reinsuring risks undertaken by various primary insurance companies. It is an arrangement which can be entered into only by insurers licensed by the states to participate in reinsurance. It amounts to insurance of insurance companies by other insurance companies. It is not an investment scheme as urged by Calvert, but is an arrangement limited only to certain insurance carriers. Calvert presents no issue as to the sale of securities to the investing public.

It is noteworthy that the federal securities laws are rapidly approaching their 50th anniversary of enactment and no other litigant has ever contended that a reinsurance pool arrangement or the sale of reinsurance by it constitutes the purchase of a security. The issue may never be raised again.

The narrow "securities" issue presented by Calvert is so limited that none of the ninety-nine other insurance carriers which entered into reinsurance contracts with American Mutual attempted to rescind its contract nor did any claim that the sale by them of reinsurance constituted the purchase by them of a "security".

The decision of the Illinois Appellate Court does not raise any important question of federal law, and does not in any way modify the established practice within the reinsurance industry. It merely reaffirms the understanding of the insurance industry that the sale of reinsurance is the sale of insurance and not the purchase of a "security".

And, of course, there is no conflict of decision created by the decision of the Illinois Appellate Court for the same reason. No court has ever been asked before, and no court may ever be asked in the future, to hold that the sale of reinsurance by a reinsurer, such as Calvert, constitutes the purchase of a "security" by the reinsurer.

IV.

The Decision of the Illinois Appellate Court Is Correct and in Accordance with the Decisions of This Court.

The Illinois Appellate Court in arriving at its decision carefully followed the guidelines laid down by this Court both in determining whether the sale by Calvert of reinsurance constituted a purchase of a "security" and whether the McCarran-Ferguson Act precluded the application of the federal securities laws to this fact situation.

Calvert takes a numerical approach to this case by implying that because this Court has construed the term "security" to include various investment plans in five of six cases, that it may be likely that this Court will construe the term "security" to encompass the reinsurance contract in question.

The fact that this Court has found the sale of real property interests, sales of variable annuities, and savings accounts to be within the definition of a security provides no support for Calvert's argument that the reinsurance contract in question constituted the sale of a security.

On the contrary, the teaching of this Court in *SEC* v. *Variable Annuity Life Insurance Co. of America*[4] and *SEC* v.

4. 359 U. S. 65 (1959).

United Benefit Life Insurance Co.[5] compels the conclusion that the reinsurance contract in question cannot be construed to be a security. The Illinois Appellate Court carefully followed this Court's guidelines in so holding.

As the legislative history of the Securities Act of 1933 and Professor Loss[6] make clear, the intent of the 1933 Act is that insurance policies and like contracts are not regarded as investment securities subject to the provisions of the Act.

Nor is it surprising that in two cases involving the sale by insurance companies of variable annuity contracts, this Court held such sales to be sales of an investment. The distinctions between the *Variable Annuity* and *United Benefit* cases and the Calvert transaction are numerous.

Neither case involved a contract of reinsurance, but both involved a variable annuity which neither Calvert nor American Mutual is authorized to sell. In the two variable annuity cases, the insurance company invested the premium with an agreement to return the proceeds. There was no investment by American Mutual for Calvert's benefit and no return of proceeds. The reason for this Court's holding in *Variable Annuity* and *United Benefit* that variable annuity contracts were not insurance policies, was that there was no underwriting of risks by the companies but merely an agreement to pay back the proceeds of investment.[7] In the instant case, underwriting risks were undertaken by both American Mutual and Calvert and results were dependent upon the acts of nature and the insurance experience of the primary insurance carriers. Further, Calvert did not buy a policy as did the purchasers of the variable annuity policies in *Variable Annuity* and *United Benefit*. It sold insurance to American Mutual.

5. 387 U. S. 202 (1967).

6. H. R. Rep. No. 85, 73rd Cong., 1st Sess. 15 (1933); 1 Loss, Securities Regulations 497 (2d Ed. 1961).

7. 359 U. S. 65, 71 (1959); 387 U. S. 202, 211 (1967).

Finally, in *Variable Annuity* and *United Benefit*, the policies were sold by insurance companies to the unsophisticated public in return for money. American Mutual did not sell a security to the public but it entered into a contract of reinsurance with Calvert whereby Calvert agreed to reinsure American Mutual.

Petitioner also contends that the Illinois Appellate Court did not follow the teaching of this Court in *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946) wherein this Court defined the test for an investment contract.

A reading of the opinion of the Illinois Appellate Court[8] indicates to the contrary. The Illinois Appellate Court quoted the test set down by this Court in *Howey* and pointed out that the reinsurance contract sold by Calvert did not meet the *Howey* test because it was a conventional insurance agreement whereby Calvert agreed for a fixed premium to reinsure certain risks. The Illinois Appellate Court noted that the fact that Calvert's ultimate income might be dependent upon losses under the policy does not alter the result because precisely the same situation occurs in every contract of insurance. As this Court has pointed out, underwriting of risks is "the one earmark of insurance as it has commonly been conceived of in popular understanding and usage."[9]

And, it is precisely because the contract in question partook of the very essence of insurance, *i.e.*, the underwriting of risks, that the Illinois Appellate Court quite properly held that the agreement constituted the "business of insurance" and that the McCarran-Ferguson Act by its express terms precluded the application of the federal securities laws to the transaction. In so doing, the Illinois Appellate Court followed the directions given by this Court in determining whether the transaction constituted the "business of insurance."[10]

8. Appendix G of Petition.

9. *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U. S. 65, 73 (1959).

10. *SEC* v. *National Securities, Inc.*, 393 U. S. 453, 459 (1969); *SEC* v *Variable Annuity Life Ins. Co.*, 359 U. S. 65, 68 (1959).

The detailed regulatory scheme of the Illinois Department of Insurance regulating insurance carriers and reinsurance activity, as set forth in the opinion of the Illinois Appellate Court, would be impaired, if not invalidated, and superseded if the federal securities acts were construed as urged by Calvert. Such a construction would be contrary to the express terms of the McCarran-Ferguson Act as construed by this Court.[11]

Finally, it is noteworthy that three different courts have already considered the "security" issue. The Circuit Court of Cook County held that there was no "security" as did the Illinois Appellate Court in a full, carefully reasoned opinion. Judge Will, who was of the opinion that it was premature to consider this issue, has stated that if called upon to decide the issue on the merits, he, too, would decide that there was no sale of a "security" to Calvert.[12]

The decision of the Illinois Appellate Court is not only correct but is in complete accord with the controlling decisions of this Court.

CONCLUSION.

It is therefore respectfully submitted, for the reasons set forth above, that Petition for Writ of Certiorari be denied.

THOMAS J. WEITHERS,
D. KENDALL GRIFFITH,
HINSHAW, CULBERTSON, MOELMANN,
HOBAN & FULLER,
69 West Washington Street,
Chicago, Illinois 60602,
(312) 630-4400,
Counsel for Respondent, American Mutual Reinsurance Company.

11. *FTC* v. *National Casualty Co.*, 357 U. S. 560 (1958).

12. Transcript of Proceedings before the Hon. Hubert L. Will on June 18, 1975 at 3, *Calvert Fire Insurance Co.* v. *American Mutual Reinsurance Co.*, No. 75 C 103 (N. D. Ill., 1975).